DrummondWoodsum
ATTORNEYS AT LAW

2010 Estate Planning Year in Review

"Lately it occurs to me what a long, strange trip it's been."
***Truckin'*, The Grateful Dead (1970)**

Congress Brings Certainty to Federal Estate Tax Planning . . . Sort of

In the weeks between Thanksgiving and Christmas 2010, the phrase "Bush tax cuts" became familiar to all of us as Congress focused its attention on tax cuts set to expire at the end of the year. In a Cinderella-type story, at the stroke of midnight on December 31, 2010, if Congress had not waved its magic wand, a series of tax cuts put in place by President George W. Bush ten years ago would have expired, returning us to laws that existed in 2001.

In a vote steeped in political overtones and influenced by social and economic policy, Congress extended the Bush tax cuts for two more years, when they will once again be set to expire at midnight on December 31, this time in 2012. For those who found it entertaining to watch the political maneuvering of a lame duck Congress after the 2010 mid-term elections, rest assured that compelling stage theater will return in 2012 when the debate over the future of the Bush tax cuts returns in the weeks following the next Presidential election.

A Bit of History

If Congress had done nothing and let the Bush tax cuts expire, the federal estate tax exemption amount (the amount that each person can leave on death to his or her non-spouse heirs, free of estate tax . . . what we refer to as the "coupon amount" or in Internal Revenue Code parlance, the "applicable exclusion amount") would have returned to $1 Million and a maximum tax rate of 55%. When President George W. Bush took office in 2001, on the heels of a $236 billion budget *surplus* in 2000, Congress passed a number of tax cuts. Among these cuts were an increase in the federal coupon amount and a decrease of the top federal estate tax rate from 55% to 45%. Congress phased in an increase of the coupon amount as follows:

2001	-	$675,000
2002 – 2003	-	$1 million
2004 – 2005	-	$1.5 million
2006 – 2008	-	$2 million
2009	-	$3.5 million
2010	-	Unlimited (estate tax "repeal")

The 2001 tax act (the "Bush tax cuts"), by its own terms, had a ten-year life span designed to expire at the end of 2010. Under the law that existed before the Bush tax cuts, the estate tax coupon was never scheduled to rise above $1 Million. Therefore, if the Bush tax cuts had expired at the end of 2010, the federal estate tax coupon would have reverted to $1 Million.

As the coupon grew from $1 Million to $2 Million, and then to $3.5 Million, everyone was confident that Congress would revisit the Bush tax cuts before 2010 to head off the scheduled repeal of the federal estate tax. Compounding the political, economic and philosophical issues inherent in a repeal of the estate tax, with the country facing unsustainable increases in the annual budget deficit, it seemed improbable that Congress would, by its own inaction, let the estate tax be

Please visit our Website

www.dwmlaw.com

Contact us

David J. Backer
dbacker@dwmlaw.com

John S. Kaminski
jkaminski@dwmlaw.com

Jessica M. Emmons
jemmons@dwmlaw.com

Maine

84 Marginal Way
Suite 600
Portland, ME
04101-2480

Phones:

207-772-1941
800-727-1941

Facsimile:

207-772-3627

New Hampshire

100 International Drive
Suite 340
Portsmouth, NH
03801

Phones:

603-433-3317
800-727-1941

Facsimile:

603-433-5384

repealed, even for one year. After all, the primary impetus for the Bush tax cuts was the budget surplus that we enjoyed for three consecutive years and was projected to continue into the future. Unfortunately, as 2010 approached, the budget surpluses of 1998, 1999 and 2000 became a fading memory.

As the clock ticked down on the final weeks of 2009, with Congress focused on a national health care program, estate tax reform fell by the wayside and the improbable happened. On January 1, 2010 the estate tax was repealed because Congress did nothing to stop it.

A number of high profile wealthy families received a financial windfall from the death of a family matriarch or patriarch during the one-year repeal: George Steinbrenner, owner of the New York Yankees, with an estimated net worth of $1.1 Billion; Walter Shorenstein, real estate developer, with an estimated net worth of $1.1 Billion; Mary Janet Cargill, of Cargill, Inc., the largest privately held corporation in the United States, with an estimated net worth of $1.7 Billion; John Kluge, owner of Metromedia, a media conglomerate, with an estimated net worth of $6.5 Billion; and Dan Duncan, an energy entrepreneur, with an estimated net worth of $9 Billion.

One of Benjamin Franklin's most frequently quoted aphorisms is that "nothing is certain but death and taxes." It turns out that Franklin was only half right. The aggregate estimated estate tax avoided by these five families by a death in 2010: $8.7 Billion.

The New Deal

Fourteen days before the Bush tax cuts were scheduled to expire, President Obama signed into law the 2010 tax act extending the tax cuts for two more years. The provisions that made the most news were an extension of the income tax rates, the capital gain rates and unemployment benefits. The estate tax provisions of the new law were a surprise gift from Santa. The estate tax provisions didn't just continue the 2009 $3.5 Million coupon amount, as many had expected would be the case . . . they increased the coupon amount to $5 Million and decreased the top estate tax rate from the 45% in effect in 2009 to 35%.

Democrats favored a continuation of 2009's $3.5 Million coupon amount and 45% maximum estate tax rate. Many Republicans supported continuing 2010's outright repeal of the estate tax. The compromise was a $5 Million coupon and a 35% maximum estate tax rate for deaths in 2011 and 2012. Beginning in 2012, the $5 Million coupon will be adjusted for inflation. Adjusting the coupon for inflation has little meaning, however, unless the law is extended beyond its initial two-year life.

With a $5 Million coupon in place, most people's heirs will never be subject to a federal estate tax, but it remains a lingering question as to whether the $5 Million coupon will last beyond 2012.

A "Portable" Coupon

The most interesting aspect of the 2010 tax law (as least for estate planners) is the addition of a new estate tax planning concept for married couples. In the past, if a married couple had an estate that was large enough to be subject to federal estate tax and the couple wanted to minimize the estate tax burden on their heirs, estate tax savings provisions needed to be in the estate planning documents of the first spouse to die. In other words, unless the coupon of the first spouse to die was used by the time of his or her death, it was lost. Because a transfer of assets to a spouse has never been subject to estate tax (assuming the surviving spouse is a U.S. citizen) the coupon was wasted when assets were left directly to a surviving spouse.

For example, assume it's the year 2002, the federal estate tax coupon amount is $1 Million, and husband and wife each have $1 Million of assets. Husband dies with a simple Will that leaves everything to his wife. There is no estate tax at husband's

death because there is no estate tax on a transfer of assets to a surviving spouse. By leaving all his assets to his wife, husband does not use his coupon and it expires at his death. Wife then dies with $2 Million of assets and leaves her entire estate to their children. Wife has a $1 Million coupon of her own, but because she didn't inherit her deceased husband's coupon (it was non-transferable), only $1 Million of her assets are protected from federal estate tax. To avoid that result and to permit husband and wife to leave their entire $2 Million estate to their children free of federal estate tax, husband's estate plan should have directed that his $1 Million of assets go to a trust for his wife (often called a Family Trust, Bypass Trust or Credit Shelter Trust). Wife could then have received the benefit of the trust for her lifetime and at her death the balance of the assets of the trust, along with her own $1 Million of assets would have gone to the children with no estate tax.

That was then. Beginning in 2011, the coupon is "portable" . . . transferable to the surviving spouse. As of January 1, husband and wife each have a $5 Million coupon. Assume husband and wife have $10 Million of assets and husband dies, leaving all of his assets to his wife using a "simple" Will. Until now, husband's coupon would have been lost at his death and wife would have ended up the owner of the entire $10 Million estate, but only have a $5 Million coupon to shelter $5 Million of assets from estate tax at her death. Under the new law, wife receives husband's $5 Million unused coupon. She can now leave the entire $10 Million estate to their children at her death and have the entire estate sheltered from federal estate tax with the use of her $10 Million coupon, half of which she received from her husband.

At first blush, portability seems to be a "big deal." For purposes of minimizing or avoiding federal estate tax, portability will permit most married couples not to worry about how assets are titled between them and permit them to avoid creating a trust for the surviving spouse for the sole purpose of avoiding wasting the coupon of the first spouse to die. But, in spite of the new portability rules, there are still many good reasons to create a trust for the benefit of a surviving spouse.

- If a couple has an estate of more than $10 Million or has reason to believe that the estate might grow to more than $10 Million after the first spouse's death, then a Family/Bypass/Credit Shelter Trust will permit the assets in the trust to continue to grow during the lifetime of the surviving spouse without the growth in value being subject to estate tax at the later death of the surviving spouse.
- A trust for a surviving spouse will protect against the risk that Congress may reduce the amount of the coupon in future years or take away the portability of the coupon (after all, the current law is in place for only two years and there's no way to know with any certainty what Congress will do at the end of 2012).
- A trust for a surviving spouse will ensure that the assets are used for the benefit of the surviving spouse and then be distributed as desired by the first spouse to die. In other words, the trust will ensure that the assets aren't left to a new spouse if the surviving spouse remarries, and will ensure that the assets aren't left to the surviving spouse's children from a prior marriage.
- A trust for a surviving spouse can provide creditor and "predator" (including divorce) protection for the surviving spouse.
- A trust can provide assurance that the funds are professionally managed and invested for the benefit of a surviving spouse who may be incapable, as a result of inexperience or disability, of properly managing the assets.
- A trust can avoid wasting the generation-skipping transfer tax exemption, which is not portable, of the first spouse to die.
- Maine and many other states have their own estate taxes. Unless Maine decides to

follow the lead of Congress and make its coupon portable, a trust for the benefit of a surviving spouse will be needed to avoid wasting the $1 Million Maine coupon of the first spouse to die.

- Same sex or unmarried partners will need to use a trust for the benefit of the surviving partner to avoid wasting the coupon of the first partner to die. The coupon is only portable between married partners. Even for a same sex couple married in a state that recognizes same sex marriage, the coupon isn't portable. For all purposes of federal law, marriage is defined as the union of a man and a woman.

To avoid the possibility of a surviving spouse remarrying and accumulating multiple coupons, Congress has capped the amount of a surviving spouse's coupon at two times the basic coupon amount. Therefore, regardless of how many times a person remarries, he or she will never be able to amass more than $10 Million in coupons (at today's current coupon rate). If a surviving spouse is predeceased by more than one spouse, the amount of unused portable coupon that is available for use by the surviving spouse is limited to the lesser of $5 million or the unused coupon of the *last* deceased spouse.

Will portability require that you change your estate planning documents? Not necessarily, but it will be a factor to consider during a *State of the Estate Review* of your estate planning.

Reunification of Gift and Estate Tax Coupons

Before 2004, the estate and gift tax systems were unified and there was a single coupon that applied to lifetime gifts and transfers on death. Since 2004, when the federal estate tax coupon increased to $1.5 Million and the gift tax coupon stayed at $1 Million, there has been a disconnect between the two tax systems. Although the federal estate tax coupon has been steadily increasing since 2001, the gift tax coupon has remained fixed at $1 Million. Beginning in 2011, the gift tax exemption is reunified with the estate tax exemption at $5 Million.

Generation-Skipping Transfer Tax

One of the more esoteric taxes, but a key part of estate planning, is the generation-skipping transfer (GST) tax. The mere thought of the GST tax can give estate planners a headache. Suffice it to say that for those who have integrated GST tax planning into their estate planning, the new law includes welcome news. The GST tax exemption is increased to $5 Million, the same as the federal estate tax exemption amount. Unlike the federal estate tax exemption, however, the GST tax exemption is not portable. If the first partner to die does not effectively use his/her GST tax exemption as part of his/her estate planning, the GST tax exemption is lost. Therefore, for couples, married or not, interested in maximizing their ability to have assets benefit multiple generations of beneficiaries without having the assets be subject to estate tax at the death of each generation, the GST tax planning provisions need to be incorporated into the estate planning documents before the first death.

Continued Estate of Confusion?

"Never put off till tomorrow what you can do the day after tomorrow." **Mark Twain**

Ever since the Bush tax cuts took effect in 2001 with a ten-year sunset provision, we've been planning in a state of limbo, waiting for Congress to provide us with long-term certainty. We expected certainty before 2009 came to a close but 2010 arrived without Congress taking action and as a result, instead of providing us with certainty, we ended up with the estate tax repealed. Finally, with two weeks to spare in 2010, rather than providing us with long-term predictability, Congress kicked the ball two years further down the road. With the current law set to expire at the end of 2012, and the coupon scheduled to revert to $1 Million as of January 1, 2013, we seem destined to repeat the estate tax debate in December 2012.

So, now we're left to start the guessing game as to what Congress will do on the eve of

expiration of the two-year extension. The prognosticators are already placing bets. Some are betting on a permanent repeal, arguing that with a $5 Million estate tax exemption, so few families will be exposed to the estate tax that it is unrealistic to keep an estate tax system in place. Others contend that the only reason the Bush tax cuts were extended was to avoid a tax increase during the worst economic recession since the Great Depression, and that, assuming the country's economic condition improves over the next two years, there will be no rational way to justify continuing the tax cuts; the need to turn our attention to reducing the unsustainable deficit will require that Congress let the Bush tax cuts expire. A third school of thought suggests that Congress intends to make the current $5 Million exemption permanent, as evidenced by the portion of the new law that adjusts the $5 Million figure by an inflation factor beginning in 2012.

Until we know what Congress' next move will be, the most productive thing we can do is ensure that our estate planning documents are designed with as much flexibility as possible to anticipate whatever the law may be on January 1, 2013.

The Maine Estate Tax

Since 2003 when Maine "de-coupled" from the federal estate tax system, Maine has had its own estate tax, with its own estate tax exemption (a "state coupon," so to speak). The Maine coupon is currently $1 Million. We expect that there will be efforts made in the current legislative session to increase the Maine coupon to match the federal coupon. We're not inclined to guess what the likelihood of success of those efforts will be. Increasing Maine's coupon would reduce estate tax revenues, and Maine, like virtually all other states, is scrambling to find every dollar of revenue possible to avoid further spending cuts. On the other hand, the Maine legislature (both House and Senate) and the governor's office are now controlled by Republicans and our new governor has expressed a desire to lower the tax burden on Maine residents.

The disparity between the $1 Million Maine coupon and the $5 Million federal coupon means that unless Maine "re-couples" with the federal estate tax, many estates will be subject to Maine estate tax even though there is no federal estate tax liability. As a result, it is important that married couples and unmarried domestic partners who have estates of more than $1 Million (including the death benefit of life insurance policies) ensure that their estate planning documents are designed to minimize Maine estate tax. In most cases, that will be accomplished by creating a trust for the benefit of the surviving spouse/partner.

Maine's $1 Million coupon is not portable. Whether Maine and other states that have estate taxes adopt the concept of portability for the state coupon remains to be seen.

The Federal Gift Tax

The annual gift tax exclusion is $13,000 and permits a person to give $13,000 a year to as many recipients as desired, without eroding the current $5 Million federal gift and estate tax coupon. Payment of tuition and certain medical expenses are not subject to gift tax and may be made in addition to the annual gift tax exclusion of $13,000.

The lifetime gift coupon is now $5 Million and is indexed to inflation to match the federal estate tax coupon. For gifts made in 2011, if the $5 Million lifetime gift coupon has been used in full, gifts in excess of the annual gift tax exclusion will be taxed at 35%. Unlimited lifetime transfers between U.S. citizen spouses remain gift tax free. In 2011, the first $136,000 of an annual gift to a non-citizen spouse is gift tax free.

Maine has no separate gift tax.

State of the Estate Review

So, what's a person to do in light of the recent changes, especially knowing that the changes are only in effect for two years?

Estate planning documents should be as flexible as reasonably possible to accommodate the changing laws, and it is essential that you take responsibility for reviewing your estate plan from time to time to ensure that your estate planning documents aren't frozen in a time warp of tax laws that no longer exist.

Estate planning has always been and will always be an intensely personal process. We pride ourselves in helping clients explore the various options available to creatively and efficiently meet their planning goals. One size does not fit all; it never will. We can't begin to know what documents are appropriate for our clients until they teach us about themselves. Similarly, our clients can't possibly know what options are best for them until we teach them about the available options. It's a two-way relationship. We each have much to learn before an estate plan can be designed and created.

Our *State of the Estate Review* is an acknowledgement that estate planning is a process, not an event. It is reasonable to expect that the decisions we make in one year will, in light of additional life experience, be subject to change to match our evolution of thought, changes in the law, changes in finances and changes in the life status of our beneficiaries. The frequency with which you update your estate plan is left to your discretion. However, if it has been more than a few years since you updated your plan, we encourage you to call to schedule a *State of the Estate Review* of your existing estate planning documents and discuss updates that may be appropriate for both tax and non-tax reasons. Absent your request to schedule a *State of the Estate Review*, we will not be responsible for reviewing or updating your estate plan to reflect changes in the law or for other purposes.

Supah Dupah Maine Lawyahs

29 lawyers at Drummond Woodsum were recognized by *Super Lawyers* and/or *Best Lawyers in America* in 2010 for their work in the fields of trust and estate planning, tax law, commercial litigation, Native American law, education law, labor and employment law, banking law, corporate law, intellectual property law, mergers and acquisitions law, bankruptcy and creditor-debtor rights law, land use and zoning law, municipal law, real estate law, public finance law and alternative dispute resolution. It's an honor to work in the midst of so many lawyers who are recognized by their peers for their professional skills.

David Backer and John Kaminski were both recognized by *Super Lawyers* and/or *Best Lawyers in America* for their work in trust and estate planning, and John was also recognized for his skill in tax and real estate law. In addition, David and John are both elected Fellows of the American College of Trust and Estate Counsel. A lawyer cannot apply for membership in the College. Fellows of the College are selected on the basis of professional reputation and ability in the fields of trusts and estates.

In 2010 David was elected Chair of Maine's Probate and Trust Law Advisory Commission, which was created by the Maine legislature in 2009. The Commission, made up of lawyers and judges, is charged with conducting a continuing study of the probate and trust laws in Maine and making recommendations to the Legislature for how those laws may be improved.

Thank You for Your Trust

Thank you for entrusting us with your estate planning. We take seriously the trust that you place in us and will continue to do everything possible to continue to earn your trust.

****

To ensure compliance with requirements imposed by the IRS, we inform you that any tax advice contained in this communication was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or tax related matter.